

To: UCLA Faculty
From: Faculty Association at UCLA
Date: April 22, 2007
Subject: Rate Increases in CalPERS Long Term Care Insurance

Most of you who signed up for CalPERS Long Term Care Insurance (LTCi) have received notices that your premiums will increase anywhere from 30 to 43% to maintain your current level of coverage. Although plans like CalPERS often promise in their sales materials that they will keep premiums level, their contracts allow them to adjust premiums to cope with higher projected payouts. In 2003, the state Legislature regulated long-term care rates for the private market, but those rules do not apply to CalPERS.

Some faculty will cancel their insurance, and this too is typical in the LTCi industry. Just when people get older and closer to needing to access coverage, the premiums are increased, and some decide to opt out. This result actually helps the insurer because it removes some of the people who would need care sooner. CalPERS offers enrollees options to pay the higher premium or reduce the level of coverage, but they provide no assistance in how to make the decision. The deadline is May 3, 2007.

Although it is wise for faculty to seek the advice of lawyers in how to read these complex LTCi policies and financial planners in how best to protect their assets, the Faculty Association thought we might offer a quick & dirty way to compare some of the options using some ball park estimates. To do this, we need to show by example. Our typical faculty member is 63 and has signed up for lifetime coverage with CalPERS for comprehensive care, at the level of \$200 a day, with inflation protection built in. His premiums are now \$1,544 but will be increased 43% on July 1 to \$2,208 if he stays with his current plan.

CalPERS presented 4 options to him:

- (1) Maintain the current coverage but with a 43% increase in premium;
- (2) No change in premium but with 30% decrease in coverage;
- (3) Change to a 3 year plan: Same level of coverage, but with a 3 year cap on years covered and a total maximum benefit amount -- this would decrease the premium about 6%;
- (4) Change to a 6 year plan: Same as (3) except with a 6 year cap -- this would require about a 31% increase in premiums.

WHICH OPTION IS THE BEST FOR HIM IF HE WERE TO NEED 5 YEARS OF LONG-TERM CARE COVERAGE IN 18 YEARS WHEN HE IS 81?

SOME ASSUMPTIONS:

Based on actuarial statistics, most people do not need more than 3 years of LTCi. Only 5% of all policy holders exhaust 4 years of benefits, and 1.5% exhaust 5 years of benefits ("LTCi Gets a Second Wind," *Journal of Financial Planning*, April 1, 2007). An earlier article in the same journal provided more detailed usage patterns. More females need LTC than males. In the 65 or over age bracket, about 33% of the males will need some kind of LTC, but 52% of the women

will. The length of stay for a male is roughly 9 months and 14 months for females (http://www.fpanet.org/journal/articles/2006_Issues/jfp1106-art7.cfm).

Based on the pattern of rate increases, CalPERS seems to expect a large number of people will require more than 3 years, given the smaller rate increases for option (3) and the much higher one for option (4) for 6 years of coverage. One of their justifications for raising premiums was that people were living longer in general, and by implication, living longer in nursing homes and assisted living.

Based on CalPERS cap rates, they assume nursing home costs to be \$192 a day; for the sake of rounding let's call it \$200. Assuming 8% inflation per year in medical prices and the "Rule of 72" (divide 72 by the rate of inflation (8%) to find out how often costs will double; in this case every 9 years), then that \$200 would jump up to \$800 in 18 years ($\$200 \times 2 \times 2$). In the same way, one should count on premiums increasing with inflation equal to or greater than costs that must be covered by benefits.

In order to keep our hypothetical example simple, we won't include the inflation factor since we want to know the relative advantage of one option in comparison to another option. Since inflation increases both premiums and benefits at about the same rate, our results for the relative advantage of one option over another without inflation will not change when inflation is taken into account.

With these numbers, living an additional 2 years in assisted living or a nursing home is no small matter – if someone opts for 3 years of coverage and actually needs, say, 5 years before death, then the last 2 years must be paid out-of-pocket. Using CalPERS caps to compute a yearly payout estimate, they are assuming they will be paying out about \$70,000 a year. So in the hypothetical example, the covered person who opted for the 3 year plan and did survive 2 years beyond must plan on additional out-of-pocket expenses of \$70,000 per year or \$140,000 for two years.

THE CalPERS OPTIONS

For all options we will assume premiums are paid for 18 years, and then there will be 5 years of LTC. We will consider Option 2 last since it involves a decrease in benefits.

Option 1: 43% premium increase for lifetime coverage

The annual premium increases to \$2,208. He pays \$39,744 in premiums and receives \$350,000 in benefits ($\$70,000 \times 5$).

Option 3: 3 years of coverage for a premium decrease of 6%

The annual premium decreases to \$1,451. He pays \$26,118 in premiums, receives \$210,000 in benefits ($\$70,000 \times 3$), and pays \$140,000 in out-of-pocket expenses for two additional years of coverage.

Option 4: 6 years of coverage for a premium increase of about 31%

The annual premium increases to \$2,023. He pays \$36,414 in premiums and receives \$350,000 (\$70,000 x 5) in benefits.

Option 2: 30% decrease in lifetime coverage keeps the premium the same

The coverage decreases \$21,000 per year and must be made up out-of-pocket. His annual premium is \$1,544. He pays \$27,792 in premiums, receives \$245,000 (\$49,000 x 5) in benefits, and pays \$105,000 out-of-pocket (\$21,000 x 5).

SUMMARY: 5 years of care in 18 years

Option 1: Lifetime Coverage: Premiums = \$39,744; Benefits=\$350,000; Net Benefit = \$310,256

Option 2: 30% decrease in Lifetime Coverage: Premiums = \$27,792; Out-of-Pocket = \$105,000; Benefits = \$245,000; Net Benefit = \$112,208.

Option 3: 3 Years of LTC Coverage: Premiums = \$26,118; Out-of-Pocket = \$140,000; Benefits = \$210,000; Net Benefit = \$43,882.

Option 4: 6 Years of LTC Coverage: Premiums = \$36,414; Benefits = \$350,000; Net Benefit \$313,586.

The most expensive option for 5 years of benefits is 3: total cost is \$166,118 for premiums and out-of-pocket expenses and benefits for 5 years only total \$210,000.

A decision as to the best option, however, also depends on the number of years of LTC. If you only need 3 years of LTC, then Option 3 is the best since it has almost the same premium as option 2 but does not have out-of-pocket expenses.

If, however, you live 2 years beyond 3 years, it is less expensive to pay for 6 years of coverage, pay the higher premiums for lifetime coverage, or even take reduced lifetime coverage.

The best deal in this hypothetical example for 5 years of LTC? Option 4, although for an extra \$3,330 in premiums Option 1 will cover the worst case scenario, namely needing more than 6 years of assisted living and/or nursing care.

DISCLAIMER: We are not advising what option should be selected. We have provided information for a hypothetical situation that may not match your particular circumstances only so that you may better understand some of the factors that may make one option the better choice over another.

A NOTE ON PREMIUMS. The longer one waits to enroll in Long Term Care Insurance, the higher the beginning rates. In addition, the cost of premiums will also increase over 18 years.

If a 63 year old faculty member were to enroll in CalPERS Long Term Care Insurance today, the premiums would be higher than for someone who is already a member for the same level of coverage. The current rates would reflect the increases both in waiting longer to join and in

absorbing the most recent rate increases. S/he would have to pay \$284 a month (\$3,408 a year) for 3 year coverage, \$397 (\$4,764 a year) for 6 year coverage, and \$477 (\$5,724 a year) for lifetime coverage, with all of the other factors the same (\$200 a day and built in inflation protection). For example, a 63 year old faculty member enrolling today for lifetime coverage would pay a yearly premium of \$5,724, or a total of \$103, 032 over 18 years.

A NOTE ON SELF INSURANCE. A faculty member would need about \$172,770 in a LTC savings account that would earn, on average, 4% after tax, to grow to \$350,000 in 18 years. If you are one of the 50% who do not need some kind of long term care, and you have about \$175,000 to dedicate to a long-term care account for yourself, you will have \$350,000 in your account in 18 years that you can spend or leave to your heirs. If you are in the other 50% who need some kind of long-term care, you will be in a position to pay for your own care for 5 years. That almost \$175,000 initial amount would be reduced somewhat for the faculty member who is already enrolled and reduced substantially for the faculty member considering enrolling in CalPERS today when the premiums are invested in this account instead of paid to CalPERS. (This assumes no inflation. If there is inflation, the amount needed will be larger than \$175,000). Unless someone has a substantial amount to dedicate to LTC initially, however, investing the premiums alone would generally not suffice to cover the care.

Still the more likely scenario is LTC for 3 years, which would be closer to \$210,000 in cost if you have no LTCi. One would need about \$103,662 invested over 18 years with 4% after tax return to generate \$210,000. If one's length of stay in a nursing home or assisted living were closer to actuarial projections (9 months for a male and 14 months for a female), then self insurance is more attractive. However, people do not know whether they will be in the norm or be one of those few who use LTC for longer periods.

CONCLUSION

Long-term care is hard to price for the insurer and hard to understand for the consumer because the future is uncertain. People don't know whether or when or for how long they are going to need LTC or if the whole environment of LTC might look different in the future. Currently only about 5% of the population carries long-term care insurance. As the baby boomers age, more and more people will need LTC who do not have either insurance or the assets to pay for it. New York state is looking into the possibility of offering to those people facing a chronic illness who do not have LTC or are uninsurable the choice of paying in advance for 3 years of long-term care or giving the state ½ their assets, whichever is less, and then the state would assume the responsibility for their care, whether it is 3 years or longer. Such a plan is also designed to discourage people from divesting their assets in anticipation of qualifying for Medicaid. If New York adopts this plan or something like it, and other states do the same, the LTC industry might change considerably based in part on the quality of the care the state can provide in such compacts.

The Faculty Association hopes that we have not presented answers as much as opened up some new paths of inquiry that might help faculty members ask better questions in order to choose the best option for them.

